DRN-3553071

The complaint

Mr W complained to Wesleyan Assurance Society (Wesleyan) about the sale of his freestanding additional contribution (FSAVC) plans. Wesleyan upheld the complaint but Mr W doesn't agree with the redress methodology used to calculate the loss he's suffered as a result of the FSAVC plans being mis-sold.

Mr W is being represented in his complaint by a claims management company. And both Mr W's representative and Wesleyan have actuaries assisting them with this matter

What happened

In 1996, Mr W was advised by Wesleyan to take out a FSAVC plan [plan 1], making contributions of £100 per month. At the time, Mr W was a member of his employer's occupational pension scheme (OPS). Mr W met with Wesleyan again in 1997 and started a further plan [plan 2], contributing £130 per month. Both plans had a retirement age of 55. Mr W ceased making contributions to both plans in September 1998.

In 2019, Mr W's representative complained to Wesleyan about the sale of the FSAVC plans. Wesleyan upheld the complaint as it wasn't satisfied that the adviser explained the in-house options Mr W had for topping up his pension through his OPS. And although Mr W had indicated in his complaint letter that he would have bought added years, Wesleyan said that the paperwork from the time of the sale showed that Mr W wanted to retire at the age of 55. And so it said it would be completing a calculation on a 'charges only' basis, i.e. a comparison of charges between the FSAVC plan and the in-house additional voluntary contribution (AVC) plan, as it was satisfied that Mr W would have gone into the in-house AVC scheme and not the added years arrangement. Wesleyan instructed its actuaries to carry out the calculation on a charges only basis.

In December 2019, Wesleyan wrote to Mr W's representative. It said that having completed its review and calculations it had determined that Mr W had not suffered a loss as a result of the advice he received to take the FSAVCs instead of being a member of the in-house AVC scheme between January 1996 and August 1998. Its letter said:

"…up to 1 October 2019, the value of the investment charges incurred within both Plans were higher than those under the AVC option by £4,068.23.

After allowance for the effect of future investment charges up to 27 October 2023, the gross value of redress required as at 1 October 2019 is £4,766.18.

[Mr W's] Plans [plan 1 & 2] benefited from a valuable Guaranteed Annuity Option (GAO) which provided for a much-enhanced annuity at retirement by comparison with a competitive annuity expected to be available in the annuity market. The enhancement in values due to the GAO has been included in our loss assessment.

Under the GAO at age 55 there is a guarantee of £6.071 per £100.00 (of the fund value) payable monthly in advance guaranteed 5 years and with no increases.

[plan 1 & 2] had a combined fund value of £49,815.10, as at 1 October 2019.

To use the funds to purchase an equivalent annuity based on the FCA calculation methodology for defined benefits, assuming retirement at age 55, would require an amount now of £80,572.19, a notional fund enhancement of £30,757.09.

The adjustment for the GAO described above is restricted to 75% of the fund, the balance being the maximum 25% of the fund which may be taken as tax free cash. It is assumed that [Mr W] will remain in good health and will not have a health impairment that will qualify for an annuity on enhanced terms.

Comparing the charges loss of £4,766.18 with the notional fund enhancement of £30,757.09 due the GAO there is a gain of £25,990.91.

As a result, no compensation is due as our calculations show that [Mr W] has incurred no financial loss."

Mr W's representative had concerns about Wesleyan's methodology so it challenged this. In summary it said that the guidance states that GAO's on FSAVCs should not be included in charges only loss assessments. This is because the calculation tables on pages 62, 63 & 65 of the guidance only include the following wording for the FSAVC side of the loss calculation, "The value of the charges incurred on the FSAVC fund up to the Calculation Date allowing for accumulation at the benchmark index" i.e., only the charges in the FSAVC should be modelled.

Wesleyan responded to Mr W's representative. It said that it was of the view that the FSAVC review guidance supports the position that the annuity guarantee may be taken into account when assessing a potential charges loss. It went on to explain that the particular FSAVC product held by Mr W has an option that provides a valuable guaranteed income in retirement, the value of which its actuaries have determined more than outweighs the higher charges deemed to be associated with the FSAVC product - as compared with the in-house money purchase AVC alternative offered by the OPS.

As no agreement could be reached on this matter, the complaint was referred to our service for consideration.

<u>My provisional findings</u>

I reviewed the complaint and issued a provisional decision in June 2022. My provisional findings are set out below.

"*Wesleyan has upheld this complaint and it considers Mr W would have joined his in-house AVC arrangement had the FSAVC plan not been mis-sold. Mr W initially complained that he would have bought added years but he no longer seems to be arguing this. And he hasn't disputed the basis on which Wesleyan has upheld his complaint. So, all that's left for me to decide is how Wesleyan needs to put matters right. However, for completeness, I should add that I agree, given what was noted in the sales paperwork about Mr W's desire to retire at 55, the in-house AVC does seem to have been a more appropriate option for him than added years.*

Following concerns about mis-selling, the regulator at that time, told businesses to carry out a review of some FSAVC plans sold between 29 April 1988 and 15 August 1999. The main aim was to review the FSAVC plans of consumers who might have lost matching contributions or subsidies that the employer would've paid, had an in-house AVC plan been started instead. The sale of Mr W's plan didn't fall within the review because the OPS *didn't match or subsidise payments to its in-house AVC arrangement.*

However, when we uphold a consumer's complaint and it's determined that they should've been advised to take in-house AVCs instead of FSAVCs, we do generally tell the business to pay compensation in accordance with the FSAVC review guidance, even if the FSAVC plan didn't fall within the scope of the review.

While acknowledging that the model guidance is useful, it's simply that - guidance. It doesn't set out rules that all businesses must follow. And, in some circumstances, it's not appropriate to apply the guidance if it will result in unfair redress for a consumer that has been mis-sold an FSAVC plan.

<u>Use of the GAO in redress calculations</u>

Having reviewed matters, I do think the guidance allows firms to consider whether no loss has been suffered by a consumer. And I also think that one of the situations where it can do this is when the FSAVC has a GAO. I've set out below the relevant section of the guidance.

> *6.25 Firms may wish to investigate whether there has in fact been no financial loss suffered despite the possible loss of employer matching contributions, subsidised benefits or lower level of charges in the in-house AVC arrangement.*
>
> *6.25.1 If the investor has lost out on employer matching contributions or other subsidised benefits, it is almost certain that a loss will have occurred. However, an example of circumstances when a loss will not have occurred is where the investment performance of the FSAVC has exceeded that of the in-house AVC arrangement by more than the cumulative value of the lost employer contributions and any difference in charges.* ***A further example might be where the FSAVC offers some kind of valuable guarantee of benefits in retirement.***
>
> *6.25.2 If a firm finds an investor for whom circumstances such as those in paragraph*
>
> *6.25.1 apply they may conclude that no loss has been suffered.*

It's evident that 6.25 allows firms to consider whether no loss has been suffered and I think the GAO would qualify as a ***"valuable guarantee of benefits in retirement****". However, I don't think it necessarily follows that it will always be fair for a firm to include its value just because an FSAVC plan has a GAO.*

I think it's important to highlight that the pensions' environment has changed significantly since the guidance was published in May 2000. The options a consumer had when taking their benefits at that time were fairly limited. And I think it's likely that it would generally have been envisaged that the majority of consumers would take an annuity when they took the benefits of their FSAVC plans. I think it would have been reasonable to suggest that many consumers would have utilised their GAOs at retirement, had that been an option on their plan. So in those circumstances, it might not have been unreasonable for a firm to consider whether the inclusion of the GAO meant that the consumer may not have suffered a loss. However, there have been several changes over the years to the rules for consumers accessing their pension via drawdown, along with major changes introduced in April 2015, widely known as pension freedoms. These changes have given consumers more flexibility in the way they can access their pension benefits. And these "freedoms" apply not only to the FSAVC plans but would also have accessible under the in-house AVC arrangement. The result of this is that there has been a considerable decline in the number of consumers taking annuities as drawdown or lump sum options are more widely available.

I note that on another case we have considered here, Wesleyan has said that where a valuable GAO exists, it would normally expect an investor to take it. I do accept those that opt to take an annuity, may well utilise any guarantees available on their plans because current annuity rates on the open market have dropped considerably. But ultimately these changes mean that not all consumers with FSAVCs are taking an annuity – and in turn they aren't utilising the GAOs - when they take their FSAVC benefits.

In the case of Mr W, the GAO adds an additional £30,757.09 to the value of the FSAVC. However, the GAO is only valuable if taken. If the consumer opts to take their benefits via any other means, the value of the GAO is irrelevant. Had Mr W been a member of his inhouse AVC, he would also have had the option to take his benefits flexibly under "freedoms" – but, as at 1 October 2019, he would have paid £4,766.18 less in charges to the AVC.

For this reason, I'm currently minded to say that, where the complaint has been upheld on the basis that the consumer would have opted to contribute to the in-house AVC, it's not appropriate for Wesleyan to take account of the value the GAO adds to the plan.

Charges and performance

However, just because Mr W would have paid less in charges, it doesn't necessarily mean that he has suffered a loss as a result of taking the FSAVC. And I'm aware that Wesleyan has raised this issue as it considers its FSAVC funds have performed particularly well.

As I've said above, I'm satisfied the regulator's FSAVC review guidance allows a firm to consider if no loss has been suffered and one of the instances where it can do so "is where the investment performance of the FSAVC has exceeded that of the in-house AVC arrangement by more than the cumulative value of the lost employer contributions and any difference in charges." So, in my final decision I intend to direct Wesleyan to carry out a comparison between the FSAVC and the in-house AVC. If it can demonstrate that the FSAVC's performance has exceeded the in-house AVC by more than the higher charges Mr W has paid, then it may conclude that he has not suffered a loss as a result of taking the FSAVC. However, if a loss is identified Wesleyan should pay Mr W the value of the excess charges.

I'm aware that, despite several attempts, Wesleyan has been unable to obtain notional values from the in-house AVC scheme. This isn't surprising given that the firm operating the scheme has changed over the years. So I have set out below, in the 'putting things right' section, details of the benchmark that Wesleyan should use to run the comparison.

What if Mr W uses the GAO when he takes his benefits?

As I understand it, Mr W is yet to take the benefits of his FSAVC plan. So I do accept there is a possibility that when he comes to take his benefits, he may opt to take an annuity with Wesleyan and utilise the GAO. If Mr W has also received a payment to reflect the higher charges he has paid to the FSAVC arrangement, this could leave him in a better position than he would have been in, had he joined his in-house AVC. He will effectively have received a refund of the higher charges and he'll also be benefitting from the increased value the GAO adds to his FSAVC fund. In these circumstances, I don't think it would be unreasonable for Wesleyan to take account of any payment it makes now as a result to the higher charges when the benefits are taken, should Mr W use the GAO"

Responses to my provisional findings

Mr W's representative responded and confirmed it had nothing further to add.

Wesleyan responded and said that whilst it maintained the view that the guaranteed benefits provided by the FSAVC plan are valuable and should be included in the loss assessment, it accepted the redress approach put forward in the provisional decision.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

I explained in my provisional decision why I intended to uphold the complaint. I appreciate Wesleyan maintains that the GAO attached to the FSAVC plan is valuable. But, for the reasons explain in my provisional decision, I don't think it's appropriate to take the value of the GAO into account.

As both parties accepted my provisional findings, I see no reason to depart from these. So I've set out below what Wesleyan needs to do to put matters right.

Putting things right

As at the date of my final decision:

If Wesleyan wishes to consider whether no loss has been suffered, it should calculate a notional value for the in-house AVC scheme as if it had performed in line with the FTSE UK Private Investors Income Total Return Index for half of the investment, and for the other half, the average rate from fixed rate bonds index. I've chosen this benchmark because this would have achieved capital growth with a small risk to the capital. The average rate for the fixed rate bonds would be a fair measure for someone who wanted to achieve a reasonable return without risk to the capital. The FTSE UK Private Investors Income total return index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return index) is made up of a range of indices with different asset classes, mainly UK equities and government bonds. It's a fair measure for someone who was prepared to take a small degree of risk to get a higher return.

So, the 50/50 combination would reasonably put Mr W into that position. It does not mean that Mr W would have invested 50% of his money in a fixed rate bond and 50% in some kind of index tracker investment. Rather, I consider this a reasonable compromise that broadly reflects the sort of return Mr W could have obtained from investments suited to his objective and risk attitude.

Wesleyan should then compare the actual value of the FSAVC with this notional value. If the actual value exceeds the notional value, no financial loss has been suffered and it need not take any further action.

The Financial Ombudsman Service uses benchmarks like this as a proxy for the typical growth that would have been achieved in investments that performed similarly to the benchmark. The aim of any benchmark used in this way is for the investment provider to achieve returns broadly in line with the benchmark, despite the charges that would ordinarily be incurred. For that reason, Wesleyan should not deduct charges when taking this particular step to calculate a notional value. This is consistent with the approach the Financial Ombudsman Service takes with such benchmarks.

If Wesleyan doesn't carry out the above comparison, or the comparison produces a loss, it must run a charges only calculation to establish the difference in charges between the FSAVC and in-house AVC. This should be run in accordance with the regulator's FSAVC review guidance, incorporating the amendment below to take into account that data for the CAPS ‘mixed with property’ index isn’t available for periods after **1 January 2005.**

The FSAVC review guidance wasn’t intended to compensate consumers for losses arising solely from poor investment returns in the FSAVC funds, which is why a benchmark index is used to calculate the difference in charges and (if applicable) any loss of employer matching contributions or subsidised benefits.

In our view the FTSE UK Private Investor Growth Total Return Index provides the closest correlation to the CAPS ‘mixed with property’ index. So where the calculation requires ongoing charges in an investment-based FSAVC and AVC to be compared after 1 January 2005, Wesleyan should use the CAPS ‘mixed with property’ index up to 1 January 2005 and the FTSE UK Private Investor Growth Total Return Index thereafter.

If a loss is identified, Wesleyan should pay Mr W the value of the excess charges as a lump sum after making a notional deduction to allow for income tax that would otherwise have been paid in retirement. 25% of the loss would be tax-free and 75% would have been taxed according to his likely income tax rate in retirement – presumed to be 40%. So making a notional deduction of 30% overall from the loss adequately reflects this

My final decision

For the reasons explained, I uphold this complaint and direct Wesleyan Assurance Society to calculate redress as set out above.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr W to accept or reject my decision before 18 July 2022.
Lorna Goulding
Ombudsman